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In The

Supreme Court of the United States

October Term, 1982

ROBERT M. SNELL and ROSALIE J. SNELL,
Husband and Wife,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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QUESTIONS PRESENTED

Petitioner respectfully submits for the Court's consideration the following questions:

(1) In the interpretation of Federal taxing statutes, may Federal Courts ignore the Cannons of Statutory Construction, when, if said Cannons were applied, the resulting interpretation would be consistent with the legislative intent in enacting said statutes.

In order to apply the Assignment of Income Doctrine, the Eighth Circuit concluded the allocation of loss was for the purpose of "tax avoidance".

(2) Did the Eighth Circuit reach a factual conclusion, tax avoidance, which is unsupported by the record thereby improperly denying a trial?

(3) Does the Assignment of Income Doctrine, as a matter of law, prohibit the allocation of preadmission loss to a newly admitted partner?

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ROBERT M. SNELL and ROSALIE J. SNELL,
Husband and Wife,

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vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

TO: The Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States.

Robert M. Snell and Rosalie J. Snell, the Petitioners herein, pray that a Writ of Certiorari issue to review the Judgment of United States Court of Appeals for the Eighth Circuit entered in this matter on June 18, 1982.

OPINIONS BELOW

The June 18, 1982, opinion of the Court of Appeals for the Eighth Circuit whose judgment is herein sought to be reviewed is 680 F. 2d 545 (1982). Such judgment is reprinted in a separate appendix to this Petition, p. App. 1. The opinion of the United States District Court for the District of Nebraska, also reprinted in the appendix, is not officially recorded. Its unofficial citation is No. CV80-L-57 (D. Neb., Sept. 14, 1981), 81-2 U. S. T. C. ¶ 9705.

JURISDICTION

The judgment of the Court of Appeals was entered on June 18, 1982. The Petition for Rehearing was denied July 26, 1982. Jurisdiction of this Court is invoked pursuant to 28 U. S. C. § 1254 (1).

STATUTES INVOLVED

The statutes are set out in the appendix.

STATEMENT OF CASE

The Petitioner filed a complaint, for refund of Federal income taxes erroneously paid, in Federal District

Court for the District of Nebraska pursuant to 28 U. S. C. 1346 (a). After the submission of pleadings and prior to any discovery, the Government's attorney submitted the following issue on a motion for summary judgment, "Whether a partner who acquired an interest in a partnership can offset his taxable income by losses incurred by the partnership prior to the acquisition." Petitioner's understanding of the motion is that it questions whether the rule of *Rodman*, 545 F. 2d 845 (C. A.-2, 1976) is correct law and whether such rule applies regardless of the way the new partner enters the partnership; capital contribution versus sale or exchange. (SEE pleading submitted July 9, 1980, Item 9 of designated record.) The District Court ruled that IRC § 706 (c) (2) (B) as in effect for 1975 and the Assignment of Income Doctrine prohibited the allocation of loss to a newly admitted partner, who was admitted by virtue of a capital contribution. The United States Court of Appeals for the Eighth Circuit affirmed the District Court's decision on June 18, 1982.

I. The canons of statutory construction must be applied if the legal interpretation resulting therefrom is consistent with the legislative intent.

The issue presented to the District Court concerned the propriety of a partnership allocating taxable loss to a newly admitted partner, which loss was incurred prior to such partner's admission. The general statutory

scheme setting out the partners' authority to allocate income involves Code §§ 704, 706 (a) and 761 (c). IRC § 704 (a) provides the general rule that *except as otherwise provided in that section,* a partner's distributive share of income, gain, loss, etc. shall be determined by the partnership agreement. IRC § 706 (a) provides that income is deemed to be allocated to the partners as of the last day of the partnership year. Reg. 1.706-1 (a). The purpose of IRC § 761 (c) is to define the term "partnership agreement" for purposes of the subchapter, especially for purposes of the general rule set out in § 704 (a). That section provides that an agreement includes all modifications to a partnership agreement up to the time fixed by law for filing a return. Reg. 1.761-1 (c). The interrelationship between these three provisions of Subchapter K infer a scheme of taxation that is extremely flexible with respect to the allocation of partnership income among partners.

IRC §§ 736, 741, 751, and 761 (d), in addition to the above, provide a statutory scheme which was generally deemed applicable to partners' dispositions of their interest in a partnership. Congress recognized that admission of a new partner by virtue of a capital contribution or a disposition by a partner of a portion or all of his interest in a partnership was a matter which involved all partners. An overwhelming majority of states provide that an individual who purchases an existing partner's interest in a partnership does not become a partner without the consent of existing partners. Consequently, the substantial differences in the taxation of a liquidation of a partner's interest, governed by IRC § 736, and a partner's sale or exchange of his interest, governed by IRC § 741, were

deemed to be a matter of form to be determined by the partners themselves. *David A. Foxman*, 41 T. C. 535, Aff'd 352 F. 2d 466; *Jackson Investment Company*, 41 T. C. 675, Rev. 346 Fed. 2d 187 (1965); *Julian T. Jacobs*, T. C. Memo, Dec. 1974-196. IRC § 761 (d) relates to the interplay of these two sections by providing that a partner whose interest is being liquidated over a series of distributions will be deemed to be a member of the partnership (in other words, will be deemed to be participating in income) until his interest is fully liquidated. Reg. § 1.761-1 (d); Reg. § 1.731-1 (a) (1) (ii).

IRC § 751 limits a partner's ability to determine the character of income (ordinary versus capital), pursuant to the partners' ability to choose the form of the transaction, by providing payments deemed attributable to unrealized receivables and substantially appreciated inventory items would be treated as ordinary income. The term "unrealized receivables" is broad and extremely inclusive. IRC § 751 (c).

In addition to the preceding, the subchapter provided an extensive statutory scheme devoted to determining a partner's basis in his partnership interest. In essence, a partner's basis reflects the partner's distributive share of income, capital contributions, and capital draws. Thus, it becomes the final arbitrator insuring that after a partner has severed his interest in a partnership, any excessive tax benefits will be recouped as capital gain and any excessive costs to the partner, not previously recognized for tax purposes, will be recognized as capital loss. IRC § 731 (a); IRC § 741; Rev. Rul. 76-189, 1976-1-C. B. 181; *Rogers*, 103 Fed. 2d 790 (9th Cir. 1939).

The general statutory framework is extremely broad allowing partners to generally, by agreement, determine their own distributive shares of partnership income and their distributive share of items that were required to be separately stated on the partnership return. This broad pattern of flexibility is consistent with the legislative intent expressed by Congress:

> "In establishing a broad pattern applicable to partnerships generally, the principal objections have been simplicity, flexibility, and equity as between partners." S. Rept. No. 1622, 83 Cong., 2nd Sess., p. 89; H. Rept. No. 1137, 83 Cong., 2nd Sess., p. 65.

David A. Foxman, supra, provides one of the most thorough discussions of the legislative intent in enacting the provisions of Subchapter K.

It was not until 1976, in a case where the Commissioner conceded an argument which he won in a tax court, that a case first held that the statutory scheme stated above was inapplicable to an allocation to a new partner admitted by virtue of a *purchase* of an interest from existing partners. *Rodman v. Commissioner*, 545 Fed. 2d 845 (C. A.-2, 1976); Rev'd T. C. Memo. 1973-27, 32 T. C. M. 1307. The taxpayer's position in *Rodman*, supra, not only required an interpretation of IRC § 706 (c) (2) (B) that is in conflict with the general rule stated in IRC § 704 (a), but it also conflicted with the Treasury Department's own regulation. Reg. § 1.704-1 (a). The theory expounded in that case and subsequent cases is a unique theory Petitioner refers to as the "Fragmentation Theory". This theory, unsupported by anything in the committee re-

ports, attempted to interpret § 706 in conflict with § 704 without interpreting § 706 in conflict with IRC § 708. IRC § 708 provided the general rules with regard to partnership terminations. The court in *Rodman* concluded that the partnership year can close only for the limited purposes of allocating income, without closing for any other purposes. This closing prevents the allocation of income or loss attributable to one period to any partner who was not a member of the partnership during that period. This fragmentation theory, that is, mini-years for allocation purposes, can provide for an unlimited number of years within a normal tax year for purposes of the allocation of income or loss.

Petitioner's arguments before the District Court and the Eighth Circuit were principally based upon the Rules of Statutory Construction. The structure of § 706 (c) is critical to its interpretation. Subsection (c) (1) provides the general rule that a partnership shall not close for various reasons including a sale or exchange of a partner's interest or the entry of a new partner, except as provided in Paragraph 2 of such subsection and IRC § 708. Paragraph 2 of Subsection (c) is itself divided into two subsections. Subsection (A) deals with a situation where a partner completely disposes of his interest by either a sale or exchange or a liquidation. Subsection (B) provides rules that deal with a partial disposition as a result of a sale or exchange or a reduction of a partner's interest.

The Petitioner's arguments before the Eighth Circuit and the District Court were based upon interpretation of three key terms in such subsection. These terms are

"item", "reduced", and "close". Petitioner's interpretation of these particular terms is based upon the interrelationship of the code sections and the committee reports surrounding the 1954 code. The resolution or interpretation of any one of these terms in accordance with Petitioner's arguments before the lower courts would have resulted in a decision, with respect to the statutes, in favor of the Petitioner.

The term "close" will be examined first since, investigating its meaning, the purpose of IRC § 706 (c) (2) becomes self-evident. It is the term relied upon but the court in *Rodman*, supra, that created this fragmentation theory; the closing for allocation purposes only. In order to interpret what is now called the Varying Interest Rule, in Paragraph (B) of § 706(c)(2), the court examined the term "closed" in Subparagraph (A) of §706 (c) (2). Of particular interest is the fact the term is used three times within Subsection (c) of § 706. In Paragraph 1, the General Rule, and Paragraph (2)(B) it is used to indicate that the partnership year shall not close. Yet the court's interpretation under *Rodman* required a closing of the partnership year not only with respect to the partner who disposed of his interest but with respect to all partners. The term "close" could not have the same meaning as used in the other parts of the same subsection or else, neither section would make sense. Petitioner resorted to the committee reports and discovered the following.

> "The bill further provides that the taxable year of a partnership is not to close as a result of the admission of a new partner. . . . Thus, it will not be possible by the admission of a new partner to termi-

nate the partnership taxable year and commence a new partnership year. However, the partnership year does close if there is a termination of the partnership.

• • •

While the partnership year does not close for the continuing partners when a partner severs his interest in the partnership, the partnership year does close with respect to such partner." House Report, United States Code Congressional and Administrative News (U.S.C.C.A.N.), Vol. 3, 83rd Cong., 2nd Session, 1954, p. 4093.

"If, however, the partnership is terminated, the taxable year of the partnership will close with respect to all the partners.

• • •

Paragraph (2) provides that, in the case of a partner whose interest is liquidated, or sold or exchanged to an outsider, the taxable year of the partnership shall close with respect to such a partner." House Report, U.S.C.C.A.N., Vol. 3, 83rd Cong., 2nd Session, 1954, p. 4366.

"While the partnership year does not close for the continuing partners when a partner severs his interest in the partnership, the partnership year does close with respect to such partner." S. Rept., U.S.C.C.A.N., Vol. 3, 83rd Cong. 2nd Session, 1954, p. 4724.

"The closing of the partnership taxable year under paragraph (2) occurs only in the case of a partner who no longer retains any interest in the partnership.

• • •

If, however, the partnership is terminated, the taxable year of the partnership will close with respect to all the partners." S. Rept., U.S.C.C.A.N., Vol. 3, 83rd Cong., 2nd Session, 1954, p. 5028.

The above committee reports illustrate that the term "close" means no more than a closing of the tax year for all purposes. Further, the reports specifically state that while the partnership year will close with respect to a partnership who completely disposes of his interest, for continuing partners the year does not close. The fragmentation theory that the year closes for continuing partners, thus prohibiting an allocation to newly admitted partner, is in direct conflict with these committee reports.

To support the court's interpretation of the varying interest rule requires different meanings of the term "close" as used within the section. Secondly, it's for the sole purpose of reading § 706(c)(2) in conflict with the general rule in § 704(a). This fragmentation theory, based upon the term "close", reads such term in conflict with Paragraph (a) of § 708. A restrictive interpretation of the term "close", as applying only to the partner disposing of his interest, enables the term to have the same definition in all places that it is used in § 706(c).

With respect to the term "item", Petitioner argued that the term as used in Section 704 (b) referred to only items that had to be separately segregated and set out on the partnership return. IRC § 702 (a) (1) through (8); IRC § 703 (a) (1). Assuming the Petitioner is correct in that interpretation, Subsection B of § 704 would not restrict rights of partners to allocate income. It would merely test the allocations of specific items to see if the principal purpose was tax avoidance and, if so, reallocate the items in accordance with each partner's distributive share of income as determined pursuant to § 704 (a). Relating that subsection to Subparagraph (c) in § 706, Petitioner argued that after a partner disposed of all or a

portion of his interest in a partnership, § 706 (c) required a re-examination of the allocation of items. If the present allocation (after the sale or liquidation) of such items constitutes tax avoidance, IRC § 706 (c) forces a reallocation of the items pursuant to a partner's *adjusted* distributive share of income. While the District Court did not openly concede Petitioner's definition of the term as used in Section 704 (b), it did feel the argument was strong enough that it had to distinguish the use of the term in Section 706 (c) (2) (B).

Petitioner feels that the use of "item" throughout Subchapter K and the Committee Reports definitely demonstrates that the term "item" cannot be used interchangeably with the term "income". It is not only the structure of § 704 (b) that supports such interpretation but the following Senate Finance Committee's report conclusively so interprets that term.

> "Subsection (b) provides that, where the partnership agreement does not provide specifically for the manner of sharing one or more of the items set forth in section 702 (a) (*other than Paragraph (9) thereof*), then, each partner's distributive share of such item shall be determined in accordance with his distributive share, as prescribed in the partnership agreement, of partnership income or loss, *exclusive of the items required to be treated separately.*
>
> • • •
>
> Subsection (b) further provides that if the principle purpose of any provision in the partnership agreement dealing with a partner's distributive share of a particular item is to avoid or evade the Federal income tax, the partner's distributive share of that item *shall be redetermined in accordance with his distributive share of partnership income or loss described*

> *in section 702 (a) (9).*" (Emphasis added). U. S. C. C. A. N., Vol. 3, 83rd Cong., 2nd Session, 1954, pp. 5020-21.

In addition, the regulations and the use of the term in several code sections also support the interpretation of the term to exclude taxable income or loss. Reg. 1.704-1(b)(1)(2); § 702(a)(9); § 702(d); § 703(a)(1).

In transposing the § 704(b) meaning of the term "item" to § 706(c), the Petitioner relied upon the rule of construction concerning identical expressions, that it is ordinarily regarded as reasonable to presume or conclude, prima facie, that words used in one place in the legislative enactment have the same meaning in every other place in the statute, especially where a word or phrase is repeatedly used therein. To include the term "income" within the meaning of the term "item" as used in § 706, the Court relied upon the citation in such subsection to § 702(a) and Treasury Regulation 1.706-1(c)(2) (ii). The following committee reports in U. S. C. C. A. N., Vol. 3, 83rd Cong., 2nd Sess., 1954, lend further credibility to the interpretation of the term to exclude income.

> "The items required to be segregated will retain their original character in the hands of the partner as though they were realized directly by him from the same source from which realized by the partnership and in the same manner. After excluding the items required to be separately treated, the remaining income or loss of the partnership under present law, is attributed to the partners." H. Rept., pp. 4091-4092.
>
> "Paragraph (9) of Subsection (a) provides that all items of income or loss, not required to be segregated by other provisions of this section, shall be attributed to each partner in accordance with his distributive share." H. Rept., discussing § 702(a)(9) at p. 4362.

> ". . . The classes of items described in Section 702(a) must be separately stated." H. Rept., discussing IRC § 703(a) at p. 4362. Same language at S. Rept. p. 5020.
>
> ". . . After excluding the items required to be separately treated, the remaining income or loss, which corresponds to be ordinary income or loss of the partnership under present law, is attributed to the partners." S. Rept., discussing IRC § 702(a) at p. 4722. SEE ALSO p. 5019 of Detailed Discussion.

More particularly, the committee reports dealing specifically with § 706(c) become a truism if the term "item" includes income and hence, the committee reports would be meaningless.

> ". . . His distributive share of partnership *items* required to be included by him in accordance with Section 702(a) will be determined by taking into account the fact that his *profit interest* may have varied during the partnership taxable year." (Emphasis added.) U.S.C.C.A.N., Vol. 3, 83 Cong., 2nd Session, 1954, H. Rept. at p. 4366, S. Rept. at 5028.

The code itself and the committee reports consistently interpret the term "item" as referring to the items separately stated in IRC § 702(a)(1) through (8). The Treasury Regulation to the extent it is inconsistent with the correct interpretation of the term is void. *Vogel Fertilizer Co.* S. Ct., No. 80-1251 (1/13/82), 82-1 U.S.T.C. ¶ 9134.

If Petitioner's interpretation of "item" is correct, IRC § 706 (c) (2) (B) would *not* prohibit the allocation of loss in this case since all items were allocated in the same proportion as income.

Petitioner cannot understand the lower court's refusal to accept Petitioner's interpretation especially when

such interpretation results in a harmonization within the provisions of § 706(c) itself and harmonization of such section with § 704(a). Further, Petitioner's interpretation is a *narrow* construction of § 706(c)(2) which is an exception to the rule provided in IRC § 706(c)(1).

Petitioner also takes issue with the lower court's interpretation of the term "reduced". Petitioner simply argued that the term as used in Subpart (B) of Paragraph (2) of § 706(c) should be interpreted consistent with Subpart (A) of such section. Subpart (A) comes into play upon either one of two events; a sale or exchange, or a liquidation. Petitioner argued that the term "reduced" referred to a partial liquidation of a partner's interest in a partnership. Such subsection would be totally inapplicable to the present case since the Petitioner acquired his interest in the partnership by virtue of a capital contribution. Instead, the lower courts concluded that *a mere reduction in a partner's percentage interest* regardless of the reason, brought the subsection, IRC § 706 (c)(2)(B), into play and required a fragmentation of the year.

All other courts which have so interpreted the term "reduce" have relied almost exclusively upon the Tax Reform Act of 1976 Committee Reports to interpret a pre-'76 law. This basis for interpretation is in conflict with several Supreme Court decisions. *Vogel Fertilizer Co.*, supra; *U.S. v. Price*, 361 U.S. 304; *Teamsters v. U.S.*, 431 U.S. 324; *Penn Mutual Life Insurance Company*, 252 U.S. 523. While heeding the preceeding authority, the District Court and the Eighth Circuit reached the same result by adopting a new rule of statutory construction; an express exception must be construed as

broadly as the general rule to which it is an exception. The court simply held that because the general rule (IRC § 706(c)(1)) used the term "entry of new partner", the term "reduced" had to be interpreted to include the entry of a new partner. This rule is in conflict with the general Cannon of Construction that exceptions must be given a narrow construction. Further, I fail to see how the general rule is given any meaning if the exception must be interpreted to include all the phrases in the general rule. Again, this term is interpreted broadly to purposely construe § 706 (c) (2) in conflict, not in harmony, with IRC § 704(a).

This new rule results in a conflict broader than just a conflict of § 704 with § 706, and § 706(c)(2) with § 706(c)(1). In order to effect any retroactive allocation even between contemporary partners, at least one partner must reduce his interest in the partnership bringing into play § 706(c)(2) which would fragment the year prohibiting such retroactive allocation. Thus, retroactive allocations between contemporary partners are impossible. Further, partial sale or exchange requires a reduction in a partner's interest so that a portion of the statute becomes redundant with no independent significance.

The cumulative effect of the interpretation given to the three terms in order to prohibit, or find a statutory basis prohibiting, the allocation of income or loss to a newly admitted partner results in an emasculation of the code.

The emasculation of the code, as in effect in 1975, is best illustrated by a review of some of the changes necessary to interpret the code consistent with the lower court's opinions.

(1) In IRC § 704(a) these words, "shall, except as otherwise provided in this section" must be replaced with the word "may".

(2) In IRC § 706(c)(1) after the term "close" and before the phrase "as a result of" the following words should be added: "the taxable year *but for purposes* of allocating income *and* for purposes of § 761(c) the partnership year shall close . . . ".

(3) In IRC § 706(c)(2)(A) a new sentence should be added stating: "such closing for the partner disposing of his interest shall close the year as to all partners for the purpose of allocating income."

(4) IRC § 706 (c) (2) (B) should have several changes.

(A) Behind the phrase "shall not close" there should be added "except for purposes of allocating income or loss".

(B) Behind the term "reduce" the code should provide "for any reason whatsoever".

(5) IRC § 761(c) should be eliminated since at least one partner must reduce his interest for any retroactive allocation. Some people may argue that the case is overstated when it's argued that IRC § 761(c) must be repealed. McKee, Nelson & Whitmire, in their book, *Federal Taxation of Partnerships and Partners,* stated with respect to the 1976 amendments to IRC § 706(c)(2)(B) that, "Unfortunately, the statutory changes, as enacted, are arguably broad enough to prohibit retroactive allocation among contemporaneous partners as well." SEE ¶ 11.04[1], pp. 11-15. The Eighth Circuit's and the District Court's interpretation of the term "reduce" to include a mere reduction of the percentage interest in the partnership is judicial construction of "reduce" as broad

as the authors fear possible. This interpretation of the 1975 code is applicable to the code as amended in 1976.

Throughout the above the Petitioner referred to several rules of statutory construction. These rules are supported by Supreme Court decisions as indicated hereinafter.

(A) Legislative intent is the controlling factor. *U.S. v. N.E. Rosenblum Truck Lines, Inc.*, 315 U.S. 50; *Ebert v. Postum*, 266 U.S. 548; *Ash Sheep Co. v. U.S.*, 252 U.S. 159; *Costanzo v. Tillinghast*, 287 U.S. 341; *Helvering v. Stockholms Enskilda Bank*, 293 U.S. 84.

(B) Express exceptions should be narrowly construed. *U.S. v. Allen*, 163 U.S. 499; *Dalehite v. U.S.*, 346 U.S. 15; *U.S. v. Public Utilities Com.*, 345 U.S. 295; *Piedmont & N.R. Co. v. I.C.C.*, 286 U.S. 299.

(C) Parts of the statutes and related statutes should be interpreted to harmonize all sections and all related statutes. *U.S. v. Fisher*, 109 U.S. 143; *McDonald v. Thompson*, 305 U.S. 263; *National Park Bank v. Remsen*, 158 U.S. 337; *Helvering v. Credit Alliance Corp.*, 316 U.S. 107.

(D) Identical expressions should have identical meaning. *Atlantic Cleaners and Dryers v. U.S.*, 286 U.S. 427; *U.S. v. Cooper Corp.*; 312 U.S. 600; *Helvering v. Stockholms Enskilda Bank*, 293 U.S. 84.

Further, this case and other cases involving the fragmentation theory amount to judicial legislation under the guise of interpretation. *U. S. v. First Nat. Bank*, 234 U.S. 245; *Shropshire, W. & Co. v. Bush*, 204 U.S. 186; *Holden v. Stratton*, 198 U.S. 202.

Basically, Petitioner feels that the Court should not unduly constrict their interpretations of the Section so

that legislative intent of flexibility and its manifest intent to allow partners to determine their own allocations is not given effect when a new partner is admitted. A restriction of the legislative intent of flexibility is not justified if such interpretation results in taxation when the statute does not otherwise clearly levy the tax.

II. The Court improperly applied the rules that relate to summary judgments to decide facts to support the application of legal principals.

The Court reached a factual conclusion, that the transaction constituted "tax avoidance", in order to apply the Assignment of Income Doctrine. The pleadings only established one relevant fact, "Plaintiff, Robert M. Snell, in 1975 became a general partner in Mid Plains Development Co., a Nebraska general partnership." The only Declaration of Record did not contain any facts. The attempt in the Declaration to incorporate facts in the Respondent's brief must fail since the brief is not part of the record and such facts amount to hearsy since the attorney for the Justice Department did not have personal knowledge of such facts within the meaning of F.R.C.P. 56(e). Basically, the Court was given purely a legal issue to decide. The Petitioner's submission by counsel of the pleading filed July 10, 1980 (Item 9 of the designated record) coupled with continued objections in Petitioner's Brief concerning submission of contested facts in briefs by the government *and* the Justice Department's cover letter to the Honorable Warren K. Urbom, indicating the issue was being submitted by agreement of counsel, unequivocally indicated that the facts of this case were irrelevant to the decision of the Court. Notwithstanding their constant submission of contested facts, the attorneys from the Justice Department never contested Petitioner's

position that the facts of this case were irrelevant to the decision of the legal issue presented. It became apparent that the Court was aware that the Petitioner had substantial means and the Court was concerned that Petitioner had already been allowed a substantial loss. During oral arguments the Honorable Judge Bright was preoccupied with whether or not the Petitioner had "a good deal". Petitioner fails to conceive how, whether the transaction was a good or bad deal, relates to the legal terms of whether or not a newly admitted partner is entitled to an allocation of preadmission income or loss. Further, before trial on its merits, even with the purported facts in the government's brief, there is no evidence regarding the individual partner's interest in cash flow, the nature of the partnership liability (recourse or non-recourse), which partner bore the risk of loss and the *value* of the contributing partner's interest immediately after the contribution as it relates to pre-existing partners' interest (Did he effectively own 100% of the partnership at that time?), etc. Both the District Court and the Eighth Circuit concluded that the application of the Assignment of Income Doctrine was proper since this was a case of "de facto" tax avoidance. Even under the Tax Reform Act of 1976, an incoming partner can deduct expenses "incurred" prior to his admission as long as they were "paid" after his admission. S. Rep. No. 938, 94th Cong., 2nd Sess. 98 (1976); Accord., H. R. Rep. No. 658, 94th Cong., 1st Sess. 124 (1975). The Supreme Court has often held that taxpayers have legal right to decrease their taxes by any legal means. *Gregory v. Helvering,* 293 U. S. 465. How can the Court distinguish legitimate tax minimization from tax avoidance prior to the trial on its merits?

The Eighth Circuit's preoccupation with facts is also illustrated by its erroneous interpretation of law as set out in its opinion. *Rodman,* supra, a sale and exchange case, was cited for its purported interpretation of the term "reduce" which is only applicable to capital contribution cases. Further, the Eighth Circuit stated that *Rodman,* supra, held that the statute would prohibit original partners from sharing in losses disproportionately for the period after the entry of the new partner. None of the cases have been concerned with the allocation of income or loss for the period after entry of the new partner.

In summation, to the extent the court based its application of the Assignment of Income Doctrine upon facts not before the court the decision should be reversed.

III. The Assignment of Income Doctrine is not applicable to partnerships.

The Eighth Circuit and the District Court concluded that the Assignment of Income Doctrine prohibits the allocation of income or loss to a newly admitted partner and that this ground was a separate and distinct basis for the decision. Petitioner takes issue with the Court's decision with respect to the Assignment of Income Doctrine for two separate reasons: (1) the Cannons of Statutory Construction, and (2) its application conflicts with prior Supreme Court cases.

IRC §704 (e) provides specific rules applicable to family partnerships. While these rules expressly state that partnerships created as a result of a gift are to be recognized, they go further and apply specific allocation rules which are similar to a codified Assignment of In-

come Doctrine. It is the general principle of interpretation that to mention one thing implies the exclusion of another; expressio unius est exclusio alterius. *Arthur v. Cumming*, 91 U. S. 362. Hence, a statute that mandates a thing to be done in a given manner, or by certain persons or entities normally implies that it shall not be done in any other manner, or by any other person or entities. *Bontany Worsted Mills v. U. S.*, 278 U. S. 282; *Raleigh & G. R. Co. v. Reid*, 80 U. S. 269. It only seems reasonable, especially in light of the fact that the Assignment of Income Doctrine was well developed by the time the 1954 code was adopted, that Congress would not codify a statute similar to the Assignment of Income Doctrine unless the doctrine is generally not applicable to partnerships. Further, it is clear that the statutory scheme provided in § 704 (a) is narrowed to the extent that § 704 (e) applies. Therefore, if the Assignment of Income Doctrine generally applies to partners it would have the result of replacing a statutory scheme that is broader than such doctrine. This would frustrate the legislative intent in enacting Subchapter K of the code.

Even two key cases which applied the Assignment of Income Doctrine to newly admitted partners conceded that the doctrine was inapplicable to the allocations of income among contemporary partners. *Rodman*, 542 Fed. 2d 845, p. 857; *Moore*, 70 T. C. 1024. These cases have given birth to a Janus-faced test for partnership allocations. One face looks to an allocation made solely among old partners and finds that this allocation does not violate the Assignment of Income Doctrine. Another face looks to an allocation made between old and new partners and finds that this allocation does violate the Assignment

of Income Doctrine. The two faces see an allocation of the same income or loss; however, the only material distinction between the two faces is the identity of the party or parties receiving the allocation. In effect, the courts determine the status (new partner vs. old partner) of a person is, of itself, determinative of tax questions. The Supreme Court has, on previous occasion, held that the status of a person is not of itself, determinative of tax questions. *Comm. v. Culbertson*, 337 U. S. 733, 746.

The application of the Assignment of Income Doctrine to this case is due to the basic misunderstanding of the entity and aggregate concepts. Generally, Subchapter K adopts the entity approach. Sen. Rept., 83-2 U. S. C. C. A. N. 1954, 2nd Sess., P. 4723. This misunderstanding is indicated by the court's insistence that the pre-existing partner incurred or sustained the loss. The statute, § 702 (b), implies that the partnership incurs or sustains the losses and that the statutory framework implementing the conduit theory is merely a statutory provision for allocating such losses among partners. The Supreme Court held that a partnership is an entity for tax purposes. *U. S. v. Basye*, 410 U. S. 441 (1973); *Federal Taxation of Partners and Partnerships* by McKee, Nelson and Whitmire, 1982 Cum. Supp., No. 2, ¶ 10.02 (3). The application of the Assignment of Income Doctrine to partnerships requires the collapsing of the entity theory. Individual partners are treated as having a fixed and determinable right to the partnership income (notwithstanding IRC § 761(c)) so that the reallocation of income to any new partner is deemed to be an allocation from one partner to another partner, rather than from the partnership among the partners.

The Supreme Court in *Comm. v. Culbertson*, supra, reviewed two prior decisions which were based upon the Commissioner's attempt to apply the Assignment of Income Doctrine to family partnerships. *Comm. v. Tower*, 327 U.S. 280; *Lusthaus v. Comm.*, 327 U.S. 293. The Court held *that once the tax court concluded that there was a valid partnership, it had no right to substitute its judgment for the judgment of the partners with respect to allocating partnership income.* Petitioner maintains this is valid legal precedent with respect to the nonfamily partnerships pr. .biting the application of Assignment of Income Doctrine. The Revenue Act of 1951 added what became IRC § 704 (e) to the 1939 code. In adding this provision, its purpose was to give effect to the Supreme Court decision, not to overrule it. House Report, U. S. C. C. A. N., Vol. 2, 82nd Cong., 1st Sess., 1951, p. 1814. Even though the amendment did provide a restrictive rule regarding the allocation of income, its intent was to give effect to *Culbertson*, supra, and to prevent the wholesale holding by the tax court that family partnerships are invalid. *Culbertson* is an effective precedent applying to nonfamily partnerships especially in light of the 1954 code's strengthening of the entity concept.

Surely, if the doctrine did not apply to family partnership case(until § 704 (e) was adopted), it would be inappropriate to apply the doctrine to nonfamily partnership when there is no similar statutory basis for its application.

The District Court and Eighth Circuit decision sets aside the statutory scheme to decide this case in direct conflict with the rule adopted in *Culbertson*, supra. Consequently, it should fail.

REASONS FOR GRANTING WRIT

Certiorari should be granted when a Federal Court of Appeals has decided a federal question in conflict with applicable decisions of the Supreme Court.

The decision of the District Court and the Eighth Circuit conflict with prior Supreme Court decisions in the following respects:

1. *Statutory Construction.* The lower courts could not support their statutory construction without a complete and utter disregard for the Cannons of Statutory Construction. These Cannons of Construction on numerous occasions have received strong support from the Supreme Court. None of the traditional reasons which would limit or set aside the rules of statutory construction are present in this case.

2. *Factual Conclusions.* The purpose of the motion was to determine whether or not as a matter of law Subchapter K prohibited the allocation of preadmission income or loss to a newly admitted partner. The question was posed in a manner where the facts of this particular case and the facts in any partnership case are irrelevant. The lower courts concluded a factual issue, tax avoidance, in order to base its application of a legal principle. As-

signment of Income Doctrine, to decide this case. The effect of this factual conclusion was to cut the Petitioner off from his right to trial on genuine issues of facts. This was an improper application of the Federal Civil Procedural Rule 56 (c). *Poller v. Columbian Broadcasting System, Inc.*, 368 U. S. 464, 7 L. Ed. 2d 458, 82 Sup. Ct. 486.

3. *Assignment of Income Doctrine.* The lower courts' decision in this case in effect set aside the statutory scheme, entity theory, in order to adopt another, aggregate theory, to premise its application of a doctrine already rejected in prior Supreme Court decisions. To the extent the lower court set aside the entity theory it is in conflict with the prior Supreme Court decision. *U. S. v. Basye*, 410 U. S. 441 (1973). The adoption of the Assignment of Income Doctrine amounts to the application of the doctrine to a nonfamily partnership under the 1954 code, which the Supreme Court would not apply to a family partnership under the 1939 code. *Comm. v. Culbertson*, 337 U. S. 733.

Petitioners feel that the role of the Cannons of Construction, judicial doctrines and legislative intent with respect to the interpretation of Federal taxing statutes is not sufficiently understood. The following is one example of the misunderstanding by each branch of the government.

1. *Executive Branch.* As part of the Tax Reform Act of 1976, Congress changed the deduction for child and dependent care expenses, IRC § 214, to a credit for child and dependent care expenses, IRC § 44A. The Senate Finance Committee stated that one of the purposes of the

change was to allow parents who have custody, but cannot claim the child as a dependent, to claim the credit. Sen. Rept. No. 94-938, P. 133; 1976-3 C. B. Vol. 3, P. 171. The joint committee specifically stated they adopted the Senate Finance Committee's version of the bill. The Internal Revenue Service proceeded to adopt the old regulations under § 214 as the new regulations under § 44A which expressly prohibit a spouse who has custody of a child to claim child care expenses unless such spouse can claim the child as a dependent. This is in direct conflict with the legislative intent behind the revisions and the adoption of the credit.

2. *The Legislative Branch.* In enacting the Revenue Act of 1978, the Senate Finance Committee felt that the term "tangible personal property" as used in IRC § 48 (a) (1) (A) could be expanded merely by *discussing* the term rather than *amending* the statute. U. S. C. C. A. N., Vol. 6, 95th Cong., 2nd Sess. 1978, P. 6880. This action by the Senate Finance Committee clearly shows that they do not appreciate the general rule that it is the intent of the Congress passing the statute, not a later Congress, which is important when interpreting a statute. *Vogel Fertilizer Co.*, S. Ct., No. 80-1251, Decided 1/13/82, 70 L. Ed. 2d 792; *U. S. v. Price,* 361 U. S. 301.

3. *Judicial Branch.* IRC § 704 (b) as in effect for 1975 provided a test which is generally referred to as the Economic Substance Test for testing the partnership's allocation of items among the partners. In two cases, the Commissioner conceded that such section, consequently the test, does not apply to partnership's allocation of bottom line income. *Boynton,* 72 T. C. 1147, Aff'd 649 Fed. 2d 1168 (C. A.-5); *Durand A. Holladay,* 72 T. C. 571, Aff'd

649 Fed. 2d 1176 (C. A.-5). The tax court and the Fifth Circuit devised a new judicial doctrine, which was referred to as the Economic Effect Doctrine, that embodied the sum and the substance of the Economic Substance Test to disallow the allocations in the case. In effect, if the statute did not apply the court was going to develop a new judicial doctrine to replace or expand the statute.

The above clearly indicates that issues concerning statutory construction are not moot and that it is a proper subject matter in need of the Court's attention. Further, the arbitrary dispensation of the Cannons of Statutory Construction in this case is not an isolated case; all segments of the government are overstepping the constitutional limits on their powers with respect to Federal taxing statutes.

Petitioner's attorney read the slogan on the ten cent stamp which is quite appropriate in this case, which states: "Peoples right to petition for redress". Is this right illusionary? Allowing courts to arbitrarily set aside the Cannons of Construction amounts to the granting of a green light to judicial legislation. Such an environment makes it impossible for advisors to properly advise clients with respect to the application of Federal taxing statutes to proposed transactions. Circuit courts, courts of last resort to more than nine out of ten Federal cases, must, when interpreting statutes, apply the Cannons of Construction.

Much press recently has been devoted to the Supreme Court's caseload. Permitting Circuit Courts to arbitrarily disregard the cannons of construction will result in a proliferation of the Supreme Court's caseload because of

conflicts between the decisions of Circuit Courts. Since this case is purely legal in nature, it presents an opportunity for the Court to speak directly and unequivocally about the principles of statutory construction.

Wherefore, Petitioner prays that the Court reverse, in total, the decision of the Court of Appeals for the Eighth Circuit and remand the case to the District Court for the District of Nebraska for further proceedings.

In the alternative, Petitioner prays that the Court:

(A) Reverse the decision of the Court of Appeals for the Eighth Circuit to the extent it improperly concluded facts and to the extent the Assignment of Income Doctrine was relied upon in conflict with prior Supreme Court decisions; and

(B) Vacate the remaining portion of the decision remanding the case to the Court of Appeals for the Eighth Circuit for an interpretation founded upon the application of the Cannons of Statutory Construction.

Respectfully submitted,

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APPENDIX A

UNITED STATES COURT OF APPEALS
For the Eighth Circuit

No. 81-2025

Robert M. Snell and Rosalie J. Snell,
husband and wife,

Appellants,

vs.

United States of America,

Appellee.

Appeal from the United States District Court
for the District of Nebraska

Submitted: May 18, 1982
Filed: June 18, 1982

Before BRIGHT and McMILLIAN, Circuit Judges, and HARRIS,* Senior District Judge.

McMILLIAN, Circuit Judge.

Robert M. Snell and Rosalie J. Snell, husband and wife, appeal an order entered in the District Court[1] for the District of Nebraska granting the government's motion for summary judgment in the Snells' tax refund suit based on the district court's finding that a taxpayer is not entitled to, as a deduction, partnership losses which had accrued prior to the taxpayer's entry into the partnership. For reversal the Snells argue that summary judgment was inappropriate because such retroactive allo-

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*The Honorable Oren Harris, United States Senior District Judge for the Eastern and Western Districts of Arkansas, sitting by designation.

[1]The Honorable Warren K. Urbom, Chief Judge, United States District Court for the District of Nebraska.

cations are not unallowable as a matter of law, but rather, they are unallowable only when the government proves that entry into the partnership was a sham or for tax avoidance. After a careful examination of the law and the record, we reject the Snells' contentions as contrary to law. Accordingly, we affirm.

The facts are not in dispute. In late December 1975, Robert Snell acquired a 49 percent interest in a Nebraska partnership in exchange for a contribution of $375,000. This acquisition reduced the interest of each of the original partners from 33⅓ per cent to 17 percent. At that time the original partners and Snell entered into an Amendment and Restatement of Partnership under which Snell was accorded 90 percent of the partnership's profits or losses for the taxable year ending December 31, 1975, and prospectively for the taxable years 1976, 1977 and 1978. For the taxable year 1979 and thereafter, Snell was to receive 49 percent of the partnership's profits or losses.

On its federal income tax return for 1975, the partnership reported a loss of $442,408. The Snells claimed 90 percent of this loss and carried it back to the years 1972, 1973 and 1974 and received a refund of all taxes paid for those years. Thereafter, the Internal Revenue Service (IRS) audited the 1975 partnership return and determined that the partnership's net operating loss was less than $442,408, and that the Snells were only entitled to report 49 percent of the partnership's loss, rather than 90 percent. In accordance with these determinations, tax deficiencies were assessed by the IRS and paid by the Snells. The Snells then initiated the present action to recover the amounts paid. The government moved for summary judgment.

The district court granted the government's motion based on its findings that a retroactive allocation to a newly admitted partner was prohibited under § 706(c)(2) of the Internal Revenue Code (the Code), relating to the taxation of partners and partnerships, and also by the allocation of income doctrine. *Snell v. United States*, No. CV 80-L-57 (D. Neb. Sept. 14, 1981), slip op, at 2-3. The court noted that this was the same result reached by all the courts which have decided the issue, *citing Rodman v. Commissioner*, 542 F. 2d 845, 858 (2d Cir. 1976); *Marriott v. Commissioner*, 73 T. C. 512 (1981), *appeal pending*, No. 81-4387 (5th Cir.); *Moore v. Commissioner*, 70 T. C. 1024 (1978).

When reviewing the district court's entry of summary judgment, this court applies the same standard as the district court. 10 C. Wright & A. Miller, Federal Practice and Procedure § 2716 (1973). Under Fed. R. Civ. P. 56(c), the motion for summary judgment should be sustained "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law."

This circuit has repeatedly emphasized the drastic nature of the summary judgment remedy. It should not be granted unless the moving party has established the right to a judgment with such clarity as to leave no room for controversy. *See Jackson v. Star Sprinkler Corp.*, 575 F. 2d 1223, 1226 (8th Cir. 1978); *New England Mutual Life Insurance Co. v. Null*, 554 F. 2d 896, 901 (8th Cir. 1977; *Robert Johnson Grain Co. v. Chemical Interchange Co.*, 541 F. 2d 207, 209 (8th Cir. 1976). The moving party

must overcome a heavy burden and the evidence is viewed in the light most favorable to the nonmoving party. The court must give the nonmoving party the benefit of all reasonable inferences to be drawn from the facts. *Adickes v. S. H. Kress & Co.*, 398 U. S. 144, 158-59 (1970); *Jackson v. Star Sprinkler Corp.*, 575 F. 2d at 1126. "However, this Circuit recognizes the remedy's salutory purpose of avoiding useless and time consuming trials." *Butler v. MFA Life Insurance Co.*, 591 F. 2d 448, 451 (8th Cir. 1979), *citing Percival v. General Motors Corp.*, 539 F. 2d 1126, 1129 (8th Cir. 1976); *Lyons v. Board of Education*, 523 F. 2d 340, 347 (8th Cir. 1975).

In the present case the district court relied on the Code provisions governing the taxation of partners and partnerships. Specifically, it found that § 706(c)(2)(B)[2] was applicable and that it precluded retroactive allocation of partnership losses or profits to newly admitted partners. That section provides that when a partner's interest is "reduced" during the taxable year, the partnership's tax year is not interrupted, but the individual partner must take this reduction into account in calculating his share of partnership items listed in § 702(a) of the Code, which includes profits or losses.

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[2]Section 706(c)(2)(B) provides:

(B) *Disposition of less than entire interest.*

The taxable year of a partnership shall not close . . . with respect to a partner who sells or exchanges less than his entire interest in the partnership or with respect to a partner whose interest is reduced, but such partner's distributive share of items described in section 702(a) shall be determined by taking into account his varying interests in the partnership during the year.

The district court reasoned that the entry of a new partner caused the original partners to have a reduced interest within the meaning of § 706(c)(2)(B). The district court further reasoned that because the statute would bar the original partners from sharing disproportionately in the partnership's losses or profits after the entry of the new partner, the statute would similarly bar the new partner from sharing disproportionately in profits or losses which accrued prior to his entry.

On appeal the Snells argue that § 706(c)(2)(B) is inapplicable because the term "reduce" only refers to reductions resulting from the sale, exchange or liquidation of a partner's interest and does not encompass entry of a new partner. Therefore, the Snells reason, there is no requirement that there be any adjustment made in the partners' shares of losses or profits due to their varying interests. In support of this argument the Snells reason that the values of the original partners' shares were not reduced because of the Snells' capital contribution. We conclude that this argument has no merit.

Section 706(c)(2)(B) of the Code refers to a reduction in interest rather than a reduction in value. It is undisputed that each original partner's interest was reduced from 33⅓ percent to 17 percent. In addition, § 706(c),[3] which sets forth the general rule as to the con-

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[3]Section 706(c) provides:

(c) *Closing of partnership year.*

(1) *General rule*

Except in the case of a termination of a partnership . . . the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership.

sequences of a change in partnership membership during the taxable year, refers not only to the sale, exchange or liquidation of a partner's interest but also to "the entry of a new partner." Reading § 706(c) in its entirety, as it should be read, we affirm the district court's finding that the term "reduced" in § 706(c)(2)(B) applied to the admission of new partners in exchange for a contribution to capital. *See Rodman v. Commissioner* 542 F. 2d at 858 (§ 706 (c) (2) (B) applies to the admission of new partners as well as to the transfer by a partner of a partnership interest).

The Snells next argue that even if § 706(c)(2)(B) is applicable, it is overridden by the mandate in § 704(a) that a partner's distributive share of the partnership's income or loss is to be determined by the partnership agreement. The Snells reason that because § 706(c)(2)(B) is not part of § 704(a), it is operative only when the partners do not have a partnership agreement which provides for the distribution of the partnership's income and loss.

The district court properly rejected this argument on the basis that § 706(c)(2)(B) is also mandatory, and its language is not limited to situations in which there is no partnership agreement to control the determination of a partner's distributive share. The district court noted that the same argument had been considered and rejected in *Rodman v. Commissioner,* 542 F. 2d 845, *Marriott v. Commissioner,* 73 T. C. 35, and *Moore v. Commissioner,* 70 T. C. 1024. The Snells have not cited any authority in support of their argument on appeal and we conclude that it has no merit.

As a second, independent ground for its decision the district court held that the assignment of income doctrine bars the allocation of pre-entry profits or losses to a new partner even if the Code is silent on this point.

On appeal the Snells argue that the doctrine has no relevance to allocations among partners because Congress intended partners to have flexibility in their profit or loss allocations as evidenced by § 761 of the Code, which gives current partners the right to adjust their respective allocations.

The district court properly rejected this argument, reasoning that § 761 did not apply to newly admitted partners because it is subject to the tax avoidance caveat of § 704(b).

We agree with the district court. Section 761 does give current partners the right to adjust their respective allocations to accurately reflect the fruitfulness, or lack thereof, of each partner's contribution of capital or services to the partnership. In that case the current partners have sustained profit or loss during the taxable year and all that remains is to determine the amount each will bear. Section 761 permits a change in this determination from that provided in the partnership agreement. However, the allocations may not be used as a vehicle to escape tax liability. § 704(b)(2); *Smith v. Commissioner*, 331 F. 2d 298, 301 (7th Cir. 1964). Therefore, § 761 has no relevance to an allocation of profit or loss to an individual who was not even a member of the partnership when that loss or profit was sustained.

We have considered the Snells' other arguments and conclude that they have no merit.

Accordingly, the judgment of the district court is affirmed.

A true copy.

ATTEST:

CLERK, U. S. Court of Appeals, Eighth Circuit

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
For the District of Nebraska

CV80-L-57

ROBERT M. SNELL and ROSALIE J. SNELL, husband and wife,

Plaintiffs,

vs.

UNITED STATES OF AMERICA,

Defendant.

ORDER

Entered on Docket: September 15, 1981
Filed: September 15, 1981

Pursuant to the accompanying memorandum of this date,

IT HEREBY IS ORDERED AND ADJUDGED that summary judgment for the defendant on the plaintiffs' claim is granted.

Dated September 14, 1981.

BY THE COURT
/s/ Warren K. Urbom
Chief Judge

MEMORANDUM

This is an action seeking refund of federal income taxes paid by the plaintiffs for their taxable years 1972, 1973, and 1974. The defendant has moved for summary judgment, filing 5. The sole issue to be decided on this motion is whether a taxpayer who acquired an interest in a partnership can offset his taxable income by losses incurred by the partnership prior to the acquisition.

The material facts relevant to the resolution of this issue are not in dispute. Sometime near the end of 1975 the plaintiff Robert M. Snell acquired a 49 per cent interest in a Nebraska partnership in exchange for a contribution of $375,000.00. This acquisition reduced the interest of each of the three original partners from 33⅓ per cent to 17 per cent. On its federal income tax return for 1975 the partnership reported a loss of $442,408.00. Pursuant to an amendment and restatement of the partnership agreement, the plaintiffs claimed 90 per cent of this loss on their joint income tax return as Mr. Snell's distributive share of the partnership loss. The plaintiffs carried back this loss to the years 1972, 1973 and 1974 and received a refund of all taxes paid for those years. Thereafter, the Internal Revenue Service audited the 1975 partnership return and determined that the partnership's net operating loss was less than $442,408.00 and that the plaintiffs were entitled to report only 49 per cent of the partnership's loss, not 90 per cent. In accord with these determinations, tax deficiencies were assessed by the IRS and paid by the plaintiff. By this action the plaintiffs seek to recover the amounts paid.

The defendant contends by its motion for summary judgment that regardless of whether the plaintiffs are entitled to 90 per cent or 49 per cent of the partnership loss for the year 1975, the only portion of the loss which they can claim is that which occurred after the acquisition of an interest in the partnership. The parties are in agreement that if the defendant prevails on this issue, the plaintiffs are not entitled to a refund.

The defendant contends that the plaintiffs cannot claim any of the partnership's losses which occurred prior

to Mr. Snell's entry as a partnership, for two reasons: it could constitute an assignment of income, and it would be inconsistent with the provisions governing the taxation of partners and partnerships.

I. Statutory provisions.

The following partnership code provisions are relevant to a resolution of the issue presented here. 1/ Section 702(a) contains the general rule that each partner must take into account in computing his income tax his distributive share of the partnership's income, gain, loss, deduction, and credit. Section 704(a) provides that except as otherwise provided in that section, a partner's "distributive share" of income, gain, loss, deduction, or credit shall be determined by the partnership agreement. As defined by § 761(a), a partnership agreement consists of any modifications made prior to or at the time prescribed by law for the filing of the partnership return for the taxable year.

Section 706(c)(1) sets forth the general rule that, except as provided in paragraph (2) of the section, the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, or the liquidation, sale or exchange of a partner's interest in the partnership. Section 706(c)(2)(B) provides that with respect to a partner who sells or exchanges less than his entire interest in the partnership or a partner whose interest is reduced, the taxable year of the partnership shall not close as to that partner, but his distributive share of the partnership income and losses shall be determined "by taking into account his varying interest in the partnership during the taxable year."

Sections 704(a) and 761(a), read together, allow partners who were members of a partnership for the full year to modify the partnership agreement at any time prior to the time for filing a return to shift income and losses among themselves as they see fit. Such modifications relate back to the beginning of the partnership year. *Smith v. Commissioner*, 331 F. 2d 298, 301 (C. A. 7th Cir. 1964); *Foxman v. Commissioner*, 41 T. C. 535, 554 (1964), aff'd 352 F. 2d 466 (C. A. 3rd Cir. 1965). The question here is whether § 706(c)(2)(B) prohibits the same "retroactive allocations" as to one who becomes a partner after the income and losses being reallocated have been incurred. 2/ *Rodman v. Commissioner*, 542 F. 2d 845, 858 (C. A. 7th Cir. 1964), holds that it does; and the United States Tax Court, citing *Rodman* as precedent, has held the same in *Moore v. Commissioner*, 70 T. C. 1024, 1031-1033 (1978), and *Marriott v. Commissioner*, 73 T. C. 35 (1980).

The plaintiffs argue that *Rodman*, *Moore*, and *Marriott* are distinguishable, in that each of those cases involved a sale or exchange of less than an entire interest in a partnership by one or more preexisting partners, while in the present case the plaintiff contributed capital to the partnership in exchange for a 49 per cent interest. The plaintiffs argue that § 706(c)(2)(B) is not applicable to a capital contribution situation.

Section 706(c)(2)(B) refers not only to a partner who "sells or exchanges less than his entire interest," but also to a partner whose interest is "reduced." 3/ The plaintiffs contend that the definition of "reduced" is limited to a partial liquidation of a partner's interest, and in support of this contention cite subpart (A) of § 706(c)

(2) which sets forth the consequences of a disposition of a partner's entire interest in the partnership in only two events—the sale or exchange of the interest or the liquidation of a partner's entire interest. From this, the plaintiffs argue that subpart (B) of § 706(c)(2) should be construed to deal with the disposition of less than an entire partnership interest in the same two limited situations. However, in so arguing the plaintiffs overlook § 706 (c), which sets forth the general rule as to the consequences of a change in partnership membership during the taxable year. That section refers not only to the sale, exchange or liquidation of a partner's interest, but also to "the entry of a new partner." The entry of a new partner via a contribution of capital in exchange for an interest in the partnership would presumably result in a reduction of the other partners' interests, and § 706(c)(2)(B) provides that when a partner's interest is reduced, that partner's distributive share of the items described in § 706(a) shall be determined by taking into account the partner's varying interests in the partnership during the taxable year. Reading § 706(c) in its entirety—as it should be read—I conclude that the term "reduced" in § 706(c)(2)(B) includes a contribution to the capital of a partnership.

The plaintiff also argues that § 706(c)(2)(B) is inapplicable to this case, because the section does not apply to § 706(a)(9)—taxable income or loss—allocations. Under § 706(c)(2)(B), the "varying interests" rule governs the determination of a partner's distributive share of "items described in section 702(a)." While it has never been judicially resolved, it has been suggested that the term "items," as used in § 704(b) of the partnership code, ap-

plies only to particular items of income, gain, loss, deduction, or credit, and not to taxable income and loss. 4/ See *Jean v. Kresser*, 54 T.C. 1621, 1631, n.5 (1970) (Where the court indicated support for this conclusion but did not resolve the issue); *Holladay v. Commissioner*, 72 T. C. 571, 587 (1979); and *Boynton v. Commissioner*, 72 T. C. 1147, 1158 (1970) (where the commissioner conceded that § 704 (b) (2) has no application to § 702 (a) (9) "bottom-line" losses); S. Rep. No. 1622, 83rd Cong., 2d Sess., 1954 U. S. Code Cong. & Admin. News 5020. However, it is the structure of § 704 (b) itself and the language of the legislative history on that section which lend support to such a suggestion. *Jean v. Kresser*, supra. Section 704(b) says that where the partnership agreement does not provide specifically for the manner of sharing any item of income, gain, loss, deduction or credit, then each partner's distributive share of that item shall be "determined in accordance with his distributive share of taxable income or loss of the partnership, as described in section 702(a) (9)." There is no comparable language in either § 706(c) (2)(B) or its legislative history which would provide support for a similar interpretation of the term "items" as used in that section; rather, § 706(c)(2)(B) refers generally to "items described in section 702(a)." This same phrase as used in § 706(c)(2)(A) has been interpreted as including taxable income and loss. Treas. Reg. § 1.706-1(c)(2)(ii). There is no reason for giving the term a different interpretation as it is used in § 706(c)(2)(B).

Finally, the plaintiffs argue that even if § 706(c)(2) (B) is deemed to be applicable to the present situation, it is overriden by the mandate in § 704(a) that a partner's distributive share of the partnership's income or loss be

determined by the partnership agreement unless otherwise provided by that section. 5/ The plaintiffs argue that since § 706(c)(2)(B) is not a part of § 704(a), it is operative only when the partners do not have a partnership agreement which provides for a distribution of the partnership's income and loss. This argument overlooks the fact that § 706 (c) (2) (B) is also mandatory, and nowhere within its language is it limited to situations where there is no partnership agreement to control the determination of a partner's distributive share. Furthermore, the argument of the plaintiffs was considered and rejected in *Rodman v. Commissioner*, supra, *Moore v. Commissioner*, supra, and *Marriott v. Commissioner*, supra.

II. Assignment-of-income doctrine.

The above interpretation of § 706(c)(2)(B) is confirmed by a consideration of the assignment-of-income doctrine. The "first principle of income taxation" is that income must be taxed to him who earns it and loss must be deducted by him who suffers it. *United States v. Basye*, 410 U.S. 411, 447 (1973); *Commissioner v. Culbertson*, 337 U.S. 733, 739-749 (1950); *Helvering v. Horst*, 311 U.S. 112, 116 (1940); *Lucas v. Earl*, 281 U.S. 111, 114-115 (1930). In accordance with these principles, Congress enacted §§ 704(a) and 761(c) to allow the members of a partnership to allocate retroactively the gains and losses of the partnership to accurately reflect the fruitfulness, or lack thereof, of each partner's contribution of capital or services to the partnership. This is so, as long as the allocations are not a vehicle to escape tax liability. Section 704(b)(2); *Smith v. Commissioner*, 331 F. 2d 298,

301 (C.A. 7th Cir. 1964). Section 760(c)(2)(B) furthers the "first principle of income taxation" by forbidding allocations of partnership income or loss to one who joins a partnership *after* such income or loss has been incurred. Because none of the newly admitted partner's contributed capital or services generated the partnership income or loss incurred prior to his entry, the newly admitted partner is not eligible to share in such income or loss. To hold otherwise would be contrary to the assignment-of-income doctrine.

For the reasons stated above, I conclude that a taxpayer who acquires an interest in a partnership cannot offset his taxable income by losses incurred by the partnership prior to the acquisition, whether the acquisition be by purchase from an individual partner or by contribution of capital to the partnership.

An order will be entered granting the defendant's motion for summary judgment.

Dated September 14, 1981.

BY THE COURT
/s/ Warren K. Urbom
Chief Judge

Footnote 1/ All references to section numbers are to sections contained in Title 26 of the United States Code, unless otherwise designated.

Footnote 2/ The Tax Reform Act of 1976, Pub. L. 94-455, sec. 213 (c), (d) and (f), 90 Stat. 1547-1548, expressly prohibits the type of retroactive allocation at issue in this case. However, in the committee reports accompanying the Act, Congress expressed its intention

that no inference was to be drawn as to the propriety or impropriety of such retroactive allocations prior to 1976. Rather, Congress stated that under the law at that time it was "unclear" whether § 706(c)(2)(B) required the inclusion of income and loss according to a partner's varying interests during the year where the partner's interest was acquired directly from the partnership. H. Rep. No. 94-658, 94th Cong., 2d Sess. 122-125, 1976 U. S. Code Cong. & Admin. News 3019, 3020; S. Rep. No. 94-938, 94th Cong., 2d Sess. 94-98, 1976 U. S. Code Cong. & Admin. News 3533, 3534.

Footnote 3/ Section 706(c)(2)(B) was amended by the Tax Reform Act of 1976, Pub. L. 94-455, sec. 213(c)(1), 90 Stat. 1547, by substituting "or with respect to a partner whose interest is reduced (whether by entry of a new partner, partial liquidation of a partner's interest, gift, or otherwise)" for "or with respect to a partner whose interest is reduced."

Footnote 4/ Section 704(b) was amended by the Tax Reform Act of 1976, Pub. L. 94-455, sec. 213(d), 90 Stat. 1548, to read:

> "A partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) shall be determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), . . ."

As amended, the section does apply to taxable income and loss of the partnership.

Footnote 5/ Section 704(a) was amended by the Tax Reform Act of 1976, Pub. L. 94-455, sec. 213(c)(2), 90 Stat. 1548, by substituting "except as otherwise provided in this chapter" for "except as otherwise provided in this section."

APPENDIX C

RELEVANT PROVISIONS OF THE INTERNAL REVENUE CODE, SUBCHAPTER K, AS IN EFFECT FOR 1975.

STATUTES INVOLVED

This case involved certain sections of Subchapter K of the Internal Revenue Code of 1954 as in effect for 1975. The following is the most relevant provisions of Subchapter K that are applicable to this case.

I.R.C. § 702. INCOME AND CREDITS OF PARTNER.

(a) General Rule—In determining his income tax, each partner shall take into account separately his distributive share of the partnership's—

(1) gains and losses from sales or exchanges of capital assets held for not more than 6 months,

(2) gains and losses from sales or exchanges of capital assets held for more than 6 months,

(3) gains and losses from sales or exchanges of property described in Section 1231 (relating to certain property used in a trade or business and involuntary conversions),

(4) charitable contributions (as defined in Section 170(c)),

(5) dividends with respect to which there is provided an exclusion under Section 116, or a deduction under Part VIII of Subchapter B,

(6) taxes, described in section 901, paid or accrued to foreign countries and to possessions of the United States,

(7) partially tax-exempt interest on obligations of the United States or on obligations of instrumentalities of the United States as described in section 35 or section 242 (but, if the partnership elects to amortize the premiums on bonds as provided in section 171, the amount received on such obligations shall be reduced by the reduction provided under section 171(a)(3)),

(8) other ITEMS* of income, gain, loss, deduction, or credit, to the extent provided by regulations prescribed by the Secretary or his delegate, and

(9) taxable income or loss, exclusive of ITEMS requiring separate computation under other paragraphs of this subsection.

(b) Character of ITEMS Constituting Distributive Share—the character of any ITEM of income, gain, loss deduction, or credit included in a partner's distributive share under paragraphs (1) through (8) of subsection (a) shall be determined as if such ITEM were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

(c) Not Relevant.

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*Emphasis is added for the Court's convenience to words which are the focal point of the controversy.

I.R.C. § 703. PARTNERSHIP COMPUTATIONS.

(a) Income and Deduction—The taxable income of a partnership shall be computed in the same manner as in the case of an individual except that—

(1) the ITEMS described in section 702(a) shall be separately stated, and

(2) Not Relevant.

(b) Not Relevant.

I.R.C. § 704. PARTNER'S DISTRIBUTIVE SHARE.

(a) Effect of Partnership Agreement—A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this section, be determined by the partnership agreement.

(b) Distributive Share Determined by Income or Loss Ratio—A partner's distributive share of any ITEM of income, gain, loss, deduction, or credit shall be determined in accordance with his distributive share of taxable income or loss of the partnership, as described in section 702(a)(9), for the taxable year, if—

(1) the partnership agreement does not provide as to the partner's distributive share of such ITEM, or

(2) the principal purpose of any provision in the partnership agreement with respect to the partner's distributive share of such ITEM is the avoidance or evasion of any tax imposed by this subtitle.

(c) Not Revelant.

(d) Not Relevant.

(e) Family Partnerships—

(1) Recognition of Interest Created by Purchase or Gift—A person shall be recognized as a partner for purposes of this subtitle if he owns a capital interest in a partnership in which capital is a material income-producing factor, whether or not such interest was derived by purchase or gift from any other person.

(2) Distributive Share of Donee Includible in Gross Income—In the case of any partnership interest created by gift, the distributive share of the donee under the partnership agreement shall be includible in his gross income except to the extent that such share is determined without allowance of reasonable compensation for services rendered to the partnership by the donor, and except to the extent that the portion of such share attributable to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. The distributive share of a partner in the earnings of the partnership shall not be diminished because of absence due to military service.

(3) Purchase of Interest by Member of Family—For purposes of this section, an interest purchased by one member of a family from another shall be considered to be created by gift from the seller, and the fair market value of the purchased interest shall be considered to be donated capital. The "family" of any individual shall include only his spouse, ancestors, and lineal descendants, and any trusts for the primary benefit of such persons.

I.R.C. § 706. TAXABLE YEARS OF PARTNER AND PARTNERSHIP.

(a) Year in Which Partnership Income is Includable—In computing the taxable income of a partner for

a taxable year, the inclusions required by Section 702 and Section 707(c) with respect to a partnership shall be based on the income, gain, loss, deduction, or credit of the partnership for any taxable year of the partnership ending within or with the taxable year of the partner.

(b) Not Relevant.

(c) Closing of Partnership Year—

(1) General Rule—Except in the case of a termination of a partnership and except as provided in paragraph (2) of this subsection, the taxable year of a partnership shall not CLOSE as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in the partnership, or the sale or exchange of a partner's interest in the partnership.

(2) Partner Who Retires or Sells Interest in Partnership—

(A) Disposition of Entire Interest—The taxable year of a partnership shall CLOSE—

(i) with respect to a partner who sells or exchanges his entire interest in a partnership, and

(ii) with respect to a partner whose interest is liquidated, except that the taxable year of a partnership with respect to a partner who dies shall not CLOSE prior to the end of the partnership's taxable year.

Such partner's distributive share of ITEMS described in section 702(a) for such year shall be determined, under regulations prescribed by the Secretary or his delegate, for the period ending with such sale, exchange, or liquidation.

(B) Disposition of Less than Entire Interest—The taxable year of a partnership shall not CLOSE (other than at the end of partnership's taxable year as determined under subsection (b)(1)) with respect to a partner who sells or exchanges less than his entire interest in the partnership or with respect to a partner whose interest is REDUCED, but such partner's distributive share of ITEMS described in section 702(a) shall be determined by taking into account his varying interests in the partnership during the taxable year.

I.R.C. § 708. CONTINUATION OF PARTNERSHIP.

(a) General Rule—For purposes of this subchapter, an existing partnership shall be considered as continuing if it is not terminated.

(b) Termination—

(1) General Rule—For purposes of subsection (a), a partnership shall be considered as terminated only if—

(A) no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership, or

(B) within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

(2) Special Rules—Not Relevant.

I.R.C. ¶ 736. PAYMENTS TO A RETIRING PARTNER OR A DECEASED PARTNER'S SUCCESSOR IN INTEREST.

(a) Payments Considered as Distributive Share or Guaranteed Payment—Payments made in liquidation of

the interest of a retiring partner or a deceased partner shall, except as provided in Subsection (b), be considered —

(1) as a distributive share to the recipient of partnership income if the amount thereof is determined with regard to the income of the partnership, or

(2) as a guaranteed payment described in Section 707(c) if the amount thereof is determined without regard to the income of the partnership.

(b) Payments for Interest in Partnership—

(1) General Rule—Payments made in liquidation of the interest of a retiring partner or a deceased partner shall, to the extent such payments (other than payments described in Paragraph (2)) are determined, under regulations prescribed by the Secretary or his delegate, to be made in exchange for the interest of such partner in partnership property, be considered as a distribution by the partnership and not as a distributive share or guaranteed payment under Subsection (a).

(2) Special Rules—For purposes of this Subsection, payments in exchange for an interest in partnership property shall not include amounts paid for—

(A) unrealized receivables of the partnership (as defined in Section 751 (c)), or

(B) good will of the partnership, except to the extent that the partnership agreement provides for a payment with respect to good will.

(C) Did not exist in 1975.

I.R.C. § 741. RECOGNITION AND CHARACTER OF GAIN OR LOSS ON SALE OR EXCHANGE.

In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in Section 751 (relating to unrealized receivables and inventory items which have appreciated substantially in value).

I.R.C. § 751. UNREALIZED RECEIVABLES AND INVENTORY ITEMS.

(a) Sale or Exchange of Interest in Partnership—The amount of any month, or the fair market value of any property, received by a transferor partner in exchange for all or a part of his interest in the partnership attributable to—

(1) unrealized receivables of the partnership, or

(2) inventory items of the partnership which have appreciated substantially in value, shall be considered as an amount realized from the sale or exchange of property other than a capital asset.

(b) Certain Distributions Treated as Sales or Exchanges—

(1) General Rule—To the extent a partner receives in a distribution—

(A) partnership property described in Subsection (a)(1) or (2) in exchange for all or a part of his interest in other partnership property (including money), or

(B) partnership property (including money) other than property described in Subsection (a)(1) or (2) in exchange for all or part of his interest in partnership property described in Subsection (a)(1) or (2),

such transaction shall, under regulations prescribed by the Secretary or his delegate be considered as a sale or exchange of such property between the distributee and the partnership (as constituted after the distribution).

(2) Exceptions—Paragraph (1) shall not apply to—

(A) a distribution of property which the distributee contributed to the partnership, or

(B) payments, described in Section 736(a), to a retiring partner or successor in interest of a deceased partner.

(c) Unrealized Receivables—For purposes of this Subchapter, the term "unrealized receivables" includes, to the extent not previously includible in income under the method of accounting used by the partnership, any rights (contractual or otherwise) to payment for—

(1) goods delivered, or to be delivered, to the extent the proceeds therefrom would be treated as amounts received from the sale or exchange of property other than a capital asset, or

(2) services rendered, or to be rendered. For purposes of this section and Sections 731, 736 and 741, such term also includes mining property (as defined in Section 617(f)(2)), Section 1245 property (as defined in Section 1245(a)(3)), Section 1250 property (as defined in Section 1250(c)) farm recapture property (as defined in Section 1251(e)(1)), and farm land (as defined in Sec-

tion 1252(a)), the extent of the amount which would be treated as gain to which Section 617(d)(1), 1245(a) or 1250(a), 1251(c) or 1252(a) would apply if (at the time of the transaction described in this Section or Section 731, 736, or 741, as the case may be) such property had been sold by the partnership at its fair market value.

(d) Inventory Items Which Have Appreciated Substantially in Value—

(1) Substantial Appreciation—Inventory items of the partnership shall be considered to have appreciated substantially in value if their fair market value exceeds—

(A) 120 percent of the adjusted basis to the partnership of such property, and

(B) 10 percent of the fair market value of all partnership property, other than money.

(2) Inventory Items—For purposes of this Subchapter the term "inventory items" means—

(A) property of the partnership of the kind described in Section 1221(1),

(B) any other property of the partnership which, on sale or exchange by the partnership, would be considered property other than a capital asset and other than property described in Section 1231,

(C) any other property of the partnership which, if sold or exchanged by the partnership, would result in a gain taxable under Subsection (a) of Section 1246 (relating to gain on foreign investment company stock), and

(D) any other property held by the partnership which, if held by the selling or distributee partner, would be considered property of the type described in Subparagraph (A), (B) or (C).

I.R.C. § 761. TERMS DEFINED.

(c) Partnership Agreement—For purposes of this subchapter, a partnership agreement includes an modifications of the partnership agreement made prior to, or at, the time prescribed by law for the filing of the partnership return for the taxable year (not including extensions) which are agreed to by all the partners, or which are adopted in such other manner as may be provided by the partnership agreement.

(d) Liquidation of a Partner's Interest—For purposes of this subchapter, the term "liquidation of a partner's interest" means the termination of a partners' entire interest in a partnership by means of a distribution, or a series of distributions, to the partner by the partnership.

APPENDIX D

FEDERAL RULES OF CIVIL PROCEDURE—SUMMARY JUDGMENT

RULE 56. SUMMARY JUDGMENT.

(a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of

20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in his favor upon all or any part thereof.

(b) For Defending Party. A party against whom a claim, counterclaim, or cross-claim is asserted or a declaratory judgment is sought may, at any time, move with or without supporting affidavits for a summary judgment in his favor as to all or any part thereof.

(c) Motion And Proceedings Thereon. The motion shall be served at least 10 days before the time fixed for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. A summary judgment, interlocutory in character, may be rendered on the issue of liability alone although there is a genuine issue as to the amount of damages.

(d) Case Not Fully Adjudicated on Motion. If on motion under this rule judgment is not rendered upon the whole case or for all the relief asked and a trial is necessary, the court at the hearing of the motion, by examining the pleadings and the evidence before it and by interrogating counsel, shall if praciable ascertain what material facts exist without substantial controversy and what material facts are actually and in good faith controverted. It shall thereupon make an order specifying the facts that

appear without substantial controversy, including the extent to which the amount of damages or other relief is not in controversy, and directing such further proceedings in the action as are just. Upon the trial of the action the facts so specified shall be deemed established, and the trial shall be conducted accordingly.

(e) Form of Affidavits; Further Testimony; Defense Required. Supporting and opposing affidavits shall be made on personal knowledge, shall set forth such facts as would be admissible in evidence, and shall show affirmatively that the affiant is competent to testify to the matters stated therein. Sworn or certified copies of all papers or parts thereof referred to in an affidavit shall be attached thereto or served therewith. The court may permit affidavits to be supplemented or opposed by depositions, answers to interrogatories, or further affidavits. When a motion for summary judgment is made and supported as provided in this rule, an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him.

(f) When Affidavits Are Unavailable. Should it appear from the affidavits of a party opposing the motion that he cannot for reasons stated present by affidavit facts essential to justify his opposition, the court may refuse the application for judgment or may order a continuance to permit affidavits to be obtained or depositions to be taken or discovery to be had or may make such other as is just.

(g) Affidavits Made in Bad Faith. Should it appear to the satisfaction of the court at any time that any of the affidavits presented pursuant to this rule are presented in bad faith or solely for the purpose of delay, the court shall forthwith order the party employing them to pay to the other party the amount of the reasonable expenses which the filing of the affidavits caused him to incur, including reasonable attorney's fees, and any offending party or attorney may be adjudged guilty of contempt.

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FILED
OCT 18 1982
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CLERK

No. 82-426

In the Supreme Court of the United States

OCTOBER TERM, 1982

ROBERT M. SNELL AND ROSALIE J. SNELL, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In this federal income tax case, petitioner[1] seeks review of the decision which denied his claim for a refund of taxes based on his attempt to deduct losses incurred by his partnership prior to his entry into that partnership.

The pertinent facts may be summarized as follows (Pet. App. 2, 10): On December 29,1975, petitioner acquired a 49% interest in what had been a three-member Nebraska partnership, in exchange for a contribution of $375,000, thereby reducing the interest of each of the original partners from 33-1/3% to 17%. The partnership agreement, as amended, accorded petitioner, *inter alia*, 90% of partnership profits or losses for its taxable year ending December 31, 1975. On its federal income tax return for 1975, the

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[1]Rosalie J. Snell is a party solely by virtue of having filed joint tax returns with her husband. References to "petitioner" are to Robert M. Snell.

partnership reported a loss of $442,408. On his federal income tax return for 1975, petitioner claimed 90% of this loss, *i.e.*, $398,168, as his distributive share. The Internal Revenue Service determined, on the basis of various adjustments, that the partnership's net operating loss was $337,232, rather than $442,408. The Internal Revenue Service also determined that petitioner was entitled to report only 49% of the partnership's loss, rather than 90%, and that the loss properly reportable on his 1975 return was $165,244 (49% of $337,232), rather than $398,168 (90% of $442,408).[2] These adjustments resulted in a deficiency of $82,261.65. Petitioner paid the deficiency and brought his refund suit in the United States District Court for the District of Nebraska. The district court held (Pet. App. 9-17) that petitioner could not recover these amounts because he was not entitled to claim a deduction for partnership losses which were sustained prior to his entry into the partnership, and the court of appeals affirmed (Pet. App. 1-8).

1. The decision below correctly denied petitioner's claim to partnership losses incurred prior to his entry into the partnership. Petitioner joined a partnership in 1975 near the close of its taxable year. He contributed $375,000, and then

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[2]Petitioner was, in fact, only entitled to either 90% of 3/365 of the 1975 partnership loss (based on the number of days of the year he was a partner), or 90% of the actual losses incurred during his membership in 1975, *i.e.*, December 29, 1975, through December 31, 1975. Hence, petitioner should have been allowed only $2,494.59 in 1975 partnership deductions (90% of 3/365 of the $337,232 allowed after audit). The Internal Revenue Service erred in allowing taxpayer far more than that to which he was properly entitled, but the statute of limitations barred any government counterclaim for further deficiencies to correct this error. The government, however, was free to defend the case on the proper ground, and to retain any monies already received. This did not amount to an untimely assertion of additional deficiencies. *Lewis* v. *Reynolds*, 284 U.S. 281, 283 (1932).

claimed a $398,168 deduction, representing his putative share of partnership losses which had accrued prior to his entry into the partnership. This deduction was barred both by the provisions of Subchapter K of the Internal Revenue Code of 1954 (26 U.S.C.), relating to partners and partnerships (Sections 701 *et seq.*), and by the assignment of income doctrine.

An individual partner can reduce his interest in the partnership during a taxable year, due to a sale, exchange, or entry of other partners. Where such a reduction in interest takes place, Section 706(c)(2)(B) of the Code requires that individual partner to take into account this reduction when determining his share of subsequent profits or losses sustained by the partnership.[3] Conversely, a new partner cannot share in profits or losses sustained by the partnership prior to his entry. The decision below so held (Pet. App. 5-6) in accord with a uniform line of authority. See, *e.g.*, *Williams* v. *United States*, 680 F.2d 382 (5th Cir.1982); *Rodman* v. *Commissioner*, 542 F.2d 845 (2d Cir.1976); *Moore* v. *Commissioner*, 70 T.C. 1024 (1978); *Marriott* v. *Commissioner*, 73 T.C. 1129 (1980); *Richardson* v. *Commissioner*, 76 T.C. 512 (1981), appeal pending, No. 81-4387 (5th Cir.).

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[3]Act of Aug. 16, 1954, ch. 736, Section 706, 68A Stat. 242-243 read, in pertinent part, for the taxable year ended December 31, 1975, as follows:

Section 706. Taxable years of partner and partnership.

* * * * *

(c) Closing of partnership year.

(1) General rule.

Except in the case of a termination of a partnership and except as provided in paragraph (2) of this subsection, the taxable year of a partnership shall not close as the result of the death of a partner, the entry of a new partner, the liquidation of a partner's interest in

Petitioner argues (Pet. 14-16) that the term "reduced" in Section 706(c)(2)(B) does not refer to a reduction in interest occasioned by the entry of a new partner. As the court of appeals noted, however, the term "entry of a new partner" is included in Section 706(c)(1) (Pet. App. 6).[4] Nor is there merit to his claim that his capital contribution enhanced the value of the partnership, and hence the value of the other partners' interests (Pet. App. 5). The Code refers to a reduction in interest, and not to value. For pre-existing partners, the Code requires them to take into account their increase or reduction in interest when computing their share of

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the partnership, or the sale or exchange of a partner's interest in the partnership.

(2) Partner who retires or sells interest in partnership.

* * * * *

(B) Disposition of less than entire interest.

The taxable year of a partnership shall not close (other than at the end of a partnership's taxable year as determined under subsection (b)(1)) with respect to a partner who sells or exchanges less than his entire interest in the partnership or with respect to a partner whose interest is reduced, but such partner's distributive share of items described in section 702(a) shall be determined by taking into account his varying interests in the partnership during the taxable year.

[4]Sections 704 and 706 were amended by the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, to make clear that allocations of pre-entry accrued gains and losses to incoming partners were barred, and that Section 706 applied to partners whose interests were reduced, as here, by the admission of a new partner. S. Rep. No. 94-938, 94th Cong., 2d Sess. 94-98 (1976). These amendments, however, merely clarified and codified prior law. *Williams* v. *United States*, *supra*, 680 F. 2d at 385-386; 1 A. Willis, *Partnership Taxation* § 24.05 (2d ed. Supp. 1981).

post-entry profit or loss. Likewise, petitioner cannot share in pre-entry profit or loss incurred at a time when his interest in the partnership was zero.[5]

Nor can petitioner claim (Pet. 11-13) that Section 706 is subordinate to Section 704, which permits partners to allocate profit or loss according to the partnership agreement.[6] Section 706(c)(2)(B) is in no way inconsistent with Section 704, and Section 706(c)(2)(B) requires that varying interests be taken into account whenever a reduction in interest occurs, as the court of appeals held (Pet. App. 6). Furthermore, Section 704(b)(2) strikes down partnership agreements which allocate profit or loss to evade taxes, and an allocation of pre-entry profit or loss to an incoming partner is a per se violation of Section 704(b). *Rodman* v. *Commissioner, supra*, 542 F.2d at 857-858.

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[5]Petitioner also argues (Pet. 11-13) that Section 706 does not encompass bottom-line profit or loss, but rather only specific items of income or deduction. Section 706(c)(2)(B), however, refers to all the items enumerated in Section 702(a), which latter section includes bottom-line profit or loss.

[6]Act of Aug. 16, 1954, ch. 736, Section 704, 68A Stat. 240-241 read, in pertinent part, for the taxable year ended December 31, 1975, as follows:

Section 704. Partner's distributive share.

(a) Effect of partnership agreement.

A partner's distributive share of income, gain, loss, deduction, or credit shall, except as otherwise provided in this section, be determined by the partnership agreement.

(b) Distributive share determined by income or loss ratio.

A partner's distributive share of any item of income, gain, loss, deduction, or credit shall be determined in accordance with his distributive share of taxable income or loss of the partnership, as described in section 702(a)(9), for the taxable year, if—

(1) the partnership agreement does not provide as to the partner's distributive share of such item, or

(2) the principal purpose of any provision in the partnership agreement with respect to the partner's distributive

2. The court of appeals also correctly held (Pet. App. 7) that the assignment of income doctrine barred petitioner's claim. That doctrine, described by this Court as the cornerstone of our system of taxation, is that income (or loss) is ascribable only to him who earns (or sustains) it. It cannot be assigned to others, which is precisely what petitioner seeks. *United States* v. *Basye*, 410 U.S. 441, 450 (1973).

Petitioner argues (Pet. 20-24) that this principle is inapplicable to partnerships. He cites Sections 704 and 761 of the Code, which allow current partners some flexibility in making end-of-year adjustments to their partnership agreement and hence in changing the amount of profit or loss reported by individual partners. But petitioner was not a member of the partnership when the losses he claims as deductions were sustained. Sections 704 and 761 therefore have no application.

Petitioner, citing *United States* v. *Basye, supra*, advances the novel contention (Pet. 22) that a partnership is a separate entity which earns income or sustains loss, and then pays it out. But *Basye* completely refutes petitioner's argument. It holds that a partnership is only a conduit of profit or loss and that individual partners are currently taxable on partnership income, even though actual distribution might occur years later, when they no longer

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share of such item is the avoidance or evasion of any tax imposed by this subtitle.

* * * * *

(d) Limitation on allowance of losses.

A partner's distributive share of partnership loss (including capital loss) shall be allowed only to the extent of the adjusted basis of such partner's interest in the partnership at the end of the partnership year in which such loss occurred. Any excess of such loss over such basis shall be allowed as a deduction at the end of the partnership year in which such excess is repaid to the partnership. * * *

belonged and would not share in it. The loss sought to be deducted by petitioner belongs to those who were members of the partnership when it was sustained. Such a loss is not held in abeyance by the partnership to be later bestowed upon others.[7]

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

OCTOBER 1982

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[7]Petitioner also contends (Pet. 18-20) that the courts below construed facts against him contrary to the standard governing summary judgment disposition. The court of appeals was fully aware of the correct standard (Pet. App. 3-4), and needed to infer no facts adversely to petitioner to decide the legal issue presented.

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